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ABSTRACT

As deliberations begin on its 1993-94 fiscal budget, California is for the second year in a row facing the likelihood of a decline in revenues. Under the governor's budget proposal, funds for schools would, for the third year in a row, remain at the same level per student in Average Daily Attendance (ADA). The lingering recession in California and the loss of jobs have combined with tax changes to create large state budget shortfalls. These budget shortfalls have put increasing pressure on state school funding. As in the state's 1992-93 budget, unusual accounting techniques and loans to school districts are proposed to make up the losses in the 1993-94 budget. Shifting property tax revenues away from cities and counties to school districts has also been proposed. Proposition 98 guarantees that a certain percentage of the state general fund shall be allocated for K-14 education. Proposition 111 allows adjustment in school funding when state general fund revenues decline. Some of these requirements and provisions were avoided by accounting practices and shifting tax dollars. Considering the expected slow growth in California's economy and the use of creative budget management, it is unlikely that per pupil funding will increase in the next few years. Tables and figures provide information on state school and general fund levels. (JPT)

CALIFORNIA SCHOOL FINANCE 1993-94: SCHOOLS ON SHAKY GROUND

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As the California Legislature begins deliberations on the state's 1993-94 budget, it faces the likelihood that for the second year in a row, General Fund revenues will actually decline from the previous year. The result of the lingering recession which has hit California particularly hard, this decline in revenues will force the Legislature to resolve a budget gap of some $8.6 billion. If it wants to establish a prudent reserve for financial contingencies, a total of $10 billion in savings and/or new revenues must be found (Legislative Analyst, 1993a). Under the Governor's current budget proposal, funds for schools would, for the third year in a row, remain at the same level per student in Average Daily Attendance (ADA). In addition, for the second year in a row, the appropriation for education would actually exceed the Proposition 98 guarantee level which, along with the state's revenues, has declined precipitously. To fund the schools, the Governor proposes taking more than $2 billion in property tax receipts from the cities and counties, giving it to the schools, and, in addition, lending school districts more than $500 million in funds from future years. These loans will be treated as educational revenues in future years, reducing the state's funding requirements at that time. The impact of this loan proposal, which was used to partially fund K-12 education in 1992-93, is to virtually eliminate real spending increases for education until at least 1995-96.

The history of how California found itself in this predicament has been documented elsewhere (see Picus, 1992 and Picus, 1993). The purpose of this paper is to describe the current funding prospects for the more than five million children enrolled in California's 1,012 school districts. The first section of the paper describes the current budget problem in California, documenting the anticipated revenue reduction and its causes. The second section describes how this revenue shortfall will impact funding for K-12 education, giving particular emphasis to the Proposition 98 financial guarantees. As indicated above, the Governor has proposed using loans and property tax shifts to provide funds to schools. While these strategies were first used in the 1992-93 budget, reliance on them for a prolonged period of time has substantial implications for school funding in future years. These issues are the topic of the third section of the paper. Another issue that has received considerable attention in this budget crisis is the funding of categorical programs. Section four offers a discussion of how funding for these programs will be affected by the current budget situation. Finally, section five offers a preview of the future and discusses options that may be available to mitigate future funding crises.

CALIFORNIA'S BUDGET CRISIS

California's weak economy has forced the state to lower its revenue projections for the current year (1992-93) and for the next fiscal year (1993-94). In addition, two tax law changes scheduled to take effect will also reduce available resources in the next fiscal year. These factors have combined to leave the state with an $8.6 billion shortfall. This section describes the problems facing the state's economy, and provides more detail on the projected shortfall.

California's Weak Economy

The recession which began in mid-1990, has yet to abate in California. By January of 1993, the state had lost a total of 836,000 jobs. In the final six months of 1992, employment fell by an average of 25,000 jobs a month (COSF, 1993). The California Commission on State Finance currently estimates that employment will continue to fall in 1993, and that the state will not begin to recoup the jobs lost in the recession until sometime in 1994 (COSF, 1993). The causes of these job losses include the national recession which accounts for an estimated 420,000 lost jobs, defense cutbacks which led to the loss of another 200,000 jobs, and other factors such as high land costs, congestion, environmental concerns, multiple regulations, and others which have made California a less desirable business environment are responsible for the remaining lost jobs (COSF, 1993).

Job growth is expected to be sluggish throughout the year due to continuing sluggish growth in the U.S. economy, continued layoffs in aerospace and defense industries, and the need for long term solutions to the state's fundamental economic difficulties. Most estimates suggest that the recovery in 1994 will be a weak one at best.

State Revenue Projections

As a result of these employment losses, there has been a considerable drop in the state's General Fund revenues. Total General Fund revenues peaked in 1991-92 at $42.026 billion. Estimated 1992-93 General Fund revenues amount to $40.942 billion and for 1993-94 the estimate is only $39.875 billion. The current (April 1993) estimate for 1992-93 is some $2.5 billion below the estimates contained in the budget that was passed in September 1992. Moreover, unbudgeted spending resulting from the lingering recession will make the total year end deficit total approximately $3.4 billion. In addition, revenues for 1993-94 are expected to be $5.2 billion below the baseline spending estimate. When combined with the need to make up the deficit from the previous year, the state faces a $8.6 billion shortfall in available revenues which must be made up by some combination of new revenues or spending cuts.

A major part of the revenue decline can be attributed to a scheduled elimination of a temporary 0.5 percent increase in the sales tax. This temporary increase in the sales tax, enacted to balance the 1991-92 budget, is slated to end on July 1, 1993. The Department of Finance estimates that this change will reduce the 1993-94 sales tax forecast by $1.4 billion. This drop is mitigated to some extent because sales are expected to improve across the state in the second half of 1993 and in 1994. As a result, the actual drop in sales tax receipts between 1992-93 and 1993-94 is estimated at approximately $850 million. A second tax change, the reintroduction of a net loss carry forward for business will become effective on July 1, 1993 as well. It is estimated that this will reduce General Fund revenues by some $231 million (Legislative Analyst, 1993a). If both of these changes are canceled, actual General Fund revenues for 1993-94 would be $800 million higher than they are estimated to be in 1992-93.

General Fund Expenditures

The recession has led to substantial reductions in the state's General Fund spending. Figure 1 shows how total General Fund expenditures have varied since 1989-90. Figure 2 provides a more graphic picture of how severe the budget reductions have been. In Figure 2, General Fund expenditures have been adjusted for changes in population and inflation. As that figure shows, General Fund expenditures in 1989-90 amounted to $1,510 per capita in 1993-94 dollars (COSF, 1993). By 1993-94, per capita General Fund expenditures are expected to decline to $1,169.

The effects of this downward pressure on state spending has varied by spending category. Figure 3 summarizes the average annual growth rate for spending by major expenditure category from 1983-84 to 1992-93, while Figure 4 displays the proposed spending growth rates by category contained in the Governor's 1993-94 budget proposal. As Figure 3 shows, state spending grew an average of 8 percent a year between 1983-94 and 1992-93. The largest increases were for corrections, welfare and health. State General Fund spending for education, by contrast, only grew an average of 7 percent a year during that time span. Part of the reason for this however was the growth in property tax revenues which helped fund some of the spending increases for education in this period.[1]

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[1]California school districts have a revenue limit which is defined by the state. A district's general aid from the state is the difference between local property tax collections, and the revenue limit. Increases in property tax collections that exceed the rate of growth in revenue limits have the effect of reducing the state's share of the total. Property tax collections are allocated using a legislatively determined formula. For more details on the revenue limit system and how property tax collections are distributed, see Picus, 1992.

Figure 4 shows that spending for 1993-94 is expected to drop an average of 5.7 percent from 1992-93 levels. Transportation, health and all other are the only spending categories slated for funding increases during 1993-94. The dramatic decline of 15.8 percent for education is misleading as it only represents the state share of total education costs which declines precipitously due to a proposed property tax shift which will transfer some $2.6 billion from cities and counties to school districts, reducing the state General Fund liability for funding the school district revenue limits. This funding shift is described in more detail in a separate section below.

As this section shows, 1993-94 General Fund revenues and expenditures in California are expected to decline from their 1992-93 levels. As a result, for the second year in a row, the Governor has proposed providing K-12 education with enough money to fund the growth in student enrollments, but no money for additional per pupil expenditures. To provide even this amount has required a considerable effort which is detailed in the next section.

FUNDING FOR CALIFORNIA'S SCHOOLS: 1993-94

The major stumbling block to passing the state's 1992-93 budget was finding adequate funding for education. As Picus (1993) shows, the final solution relied on a number of unusual accounting techniques including loaning districts money they had already received, and loaning them resources against future funding guarantees. While the Governor's budget proposes similar accounting techniques for the 1993-94 fiscal year, a shift of property taxes away from cities and counties to school districts is also contained in the Governor's recommendations. The budget proposes expenditures of $28.3 billion from all sources for K-12 education in 1993-94, including $13.7 billion from the General Fund. The total of $28.3 billion is $70 million (0.2 percent) less than estimated expenditures from all sources for the current year (1992-93). The following sections describe the various funding techniques used to meet the requirements of

Proposition 98 and to provide the same level of spending per ADA for schools in 1993-94.

Proposition 98 and the Backward Loan

The specific details of Proposition 98 are described in Picus, 1992 and Picus 1993. Basically, this voter approved measure guarantees that a certain portion of the state's General Fund budget will be dedicated to K-14 education. Of this guarantee, 89 percent is devoted to K-12 schools, with the remaining 11 percent given to community colleges. Proposition 98 contains three tests to determine the level of funding for schools. Test 1 guarantees that the schools will receive the same percentage of the state's General Fund budget that they received in the base year of 1986-87 or approximately 40 percent. Test 2 provides that the schools will receive at least as much as they did the prior year adjusted for changes in enrollment and inflation.

These two tests should guarantee that spending for education would increase at least moderately each year. However, under Proposition 111, passed in 1990, a third test was established. In years when state General Fund revenues decline, funds for schools can be adjusted to correspond to the change in the growth rate of General Fund revenues. There is a provision that assures school funding will not be reduced at a greater rate than other state services know as the "equal pain equal gain" provision. In recent years, under this Test 3, as the state's revenues have not only declined, but where the revenue estimates contained in the budget bill have not materialized, the state's funding requirement for schools has similarly declined. In both 1990-91 and 1991-92 the initial appropriation for schools turned out to be too high because of overly optimistic revenue projections. Rather than force school districts to give the money back to the state, these funds were "loaned" to the districts, and treated as part of the Proposition 98 revenue guarantee for the next year. These "loans" amounted to $1.3 billion between 1990-91 and 1991-92, and $1.1 billion between 1991-92 and 1992-93. The 1993-94 budget proposal assumes a similar "loan" of $460 million in funds that were appropriated to schools in 1992-93 above the Proposition 98 requirement.

The Forward Loan

In developing the budget for 1992-93, in order to maintain the current level of spending per ADA, the Proposition 98 guarantee would have to have been exceeded. To minimize the impact of this funding decision on future state commitments, rather than simply appropriate the funds to schools, the money was lent to the schools to be paid for in future years as part of the funding guarantee. A total of $732 million was loaned to the K-12 schools for 1992-93 to be paid back over the next two years. Because the California state accounting system does not require that funds be budgeted until they are actually appropriated, the $732 million was not part of the 1992-93 budget. This amount will only become part of the budget when it is appropriated as part of school district revenue in future years, that is when the funds are "paid back." This has a secondary benefit of allowing the state to avoid suspending Proposition 98, but keeping the funds off the current budget.

For 1993-94, the Governor has proposed a similar loan in the amount of $540 million. Since the earlier loan would not have to be repaid,[2] total outstanding loans would be nearly $1.3 billion. If the loan to the community colleges in 1992-93 is included, the total approaches $1.5 billion. These so called loans represent real reductions in available revenue to schools in future years, and the Legislative Analyst (1993b) estimates that as a result, it is unlikely there will be any cost of living adjustments for per pupil funding until 1995-96. This means that per pupil spending for schools in California will remain at the same level from 1991-92 through 1994-95, a total of 4 years. If the economy performs poorly in 1994, it could be one or more years beyond that before the state is able to increase per pupil educational spending. To date,

[2]The 1992-93 budget agreement contained language specifying that if state revenues were not adequate to meet school district funding requirements in 1993-94, the repayment of the loan would be held off until the state revenue picture was better.

the state has managed to fully fund increases in enrollment, but this is in large part because much of the anticipated enrollment growth for 1992-93 did not materialize. It is not clear if this is a new trend, or the result of the recession. How student enrollment will grow in future years is still a matter of considerable debate among school officials.

The Property Tax Shift

Another way the Legislature managed to balance the 1992-93 state budget and maintain its commitment to fully fund Proposition 98 was to shift some property taxes from cities and counties to school districts. Recall that under the state's revenue limit system, a school district's general state aid is the difference between its property tax receipts and its revenue limit entitlement. Under Proposition 13, all property taxes are limited to 1 percent of assessed value, and the Legislature determines how those taxes are to be distributed among jurisdictions.

Until last year (1992-93) property taxes were collected on a county wide basis and distributed to government jurisdictions in proportion to their property tax receipts in the county prior to the passage of Proposition 13. For 1992-93, the Legislature shifted $1.4 billion of property tax revenue from the cities and counties, and gave it to the schools. This did not increase the amount of money available to schools, all it did was reduce the state's funding commitment under Proposition 98 by the same $1.4 billion. For 1993-94, the Governor has proposed shifting an additional $2.6 billion in property tax revenues from the cities and counties to the school districts. As in the previous year, this does not provide any more money for the schools, it simply reduces the state's General Fund commitment.

Table 1 provides a ten year history of total funding for K-12 education, while Table 2 shows how percentage of revenues available from each funding source over the same ten year period. What is immediately clear from both of the tables is the effect of the property tax shift. If the proposed shift is approved by the Legislature, the state share of total revenues will decline to just over 50 percent in 1993-94.

One of the problems with this proposed property tax shift is that the mechanism for allocating property taxes across taxing jurisdictions has not been proposed. There is concern that in some counties, once the shift is implemented, property tax collections for schools will exceed the total revenue limits of the school districts in the county.[3] Even if the allocation formula is designed to make sure that all of the property taxes to be allocated to school districts in a county are distributed to districts up to their revenue limits, before any district receives state aid (other than the $120 basic aid grant), the Legislative Analyst estimates that there will still be a number of counties where total property tax collections exceed the revenue limit total. The Legislative Analyst estimates that this could amount to as much as $400 million that should either be recaptured by the state, or returned to the cities and the county government (Legislative Analyst, 1993b).

In summary, total revenues for schools in 1993-94 will remain flat compared to the pervious year, but there are likely to be a number of significant changes in the way those funds are collected. The most significant change is the proposed property tax shift although there has been no discussion as to how cities and counties would make up the $2.6 billion loss of funds.

CATEGORICAL GRANTS

Something on the order of 25 percent of total state aid to school districts is distributed through 37 different categorical funding programs. Because of the funding shortage in 1992-93, many of these programs were combined into a mega-item appropriation. Each district's total allocation of categorical funds was then reduced by 2.2 percent, but the districts were granted some flexibility in how the funds could be

[3] In reality, the situation is slightly more complicated. Under a 1952 amendment to the state constitution, every district in the state receives a basic aid grant of $120 per ADA. Thus, even if total property tax collections are adequate to fully fund the revenue limit, each district will still receive its basic aid grant.

used. Up to 5 percent of each program's funding level could be shifted to other categorical programs.

For 1993-94, the Governor has proposed a similar mega-item appropriation, but with a 1.55 percent growth adjustment. The Legislative Analyst(1993b) has argued that there are too many categorical programs and that they should be consolidated into three block grant programs as follows:

- School Improvement Block Grant
- School Incentives Award Program
- High School At Risk Block Grant

The Legislature is currently giving serious consideration to re configuring the entire categorical grant structure. At the present time, most categorical grants are given to school districts on the basis of historical patterns, not current needs. As a result, many new categorical programs have been established over the years by the legislature to give specific categories of districts additional funding. This has been a way to provide individual districts with more funds without having to spend the total amount of money that would be necessary to raise the revenue limits (general aid) of all school districts. Perhaps the most clear-cut example of this behavior was the state's supplemental grant program. For each of three years, the Legislature appropriated $180 million in grants that went to school districts that had low revenue limits, but that also received low per pupil revenues from 27 other categorical grants. In other words, districts qualified for these categorical grants because they did not have special needs for which other categorical grants were provided. This year, those funds were rolled into district revenue limits, but the effect of the program, to reward districts with few categorical programs, remains.

THE FUTURE OF EDUCATIONAL FINANCE IN CALIFORNIA

For at least the third year in a row, the school finance picture in California is very bleak. It is unlikely to get better in the foreseeable future. Between gloomy economic projections for the state, and the use of creative budget accounting tricks to balance recent state budgets, it is unlikely that schools can expect to see any increases in per pupil funding for the next two or possibly three years. This has caused tremendous fiscal stress in a number of districts, most notably the Los Angeles Unified School District (LAUSD). Faced with funding reductions, the district has cut over $1 billion from its proposed budgets over the past four years. This year (1992-93) the district was forced to cut teacher salaries by 10 percent. Other districts have teetered on the brink of bankruptcy for a number of months, and it is likely that some will run out of funds before the 1993-94 fiscal year ends.

Unfortunately, a solution for this dilemma is not in sight. The state's tax system is suffering from the dual effects of the 1 percent property tax limitation and the recessionary impact on sales and income taxes. The economic recovery is stalled, and prospects for a quick turn-around are all but hopeless. Thus, districts will have no choice but to do with what they already have. The future of California's children depends on their ability to do so.

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Table 1
K-12 Education Funding By Source
1984-85 Through 1993-94
(Millions of Dollars)

Year	State Funds	Local Property Tax Levies	Lottery Funds	Federal Funds	Other Local Sources	Total
1984-85	$9,940	$3,298	-	$1,095	$918	$15,251
1985-86	$10,805	$3,596	$556	$1,126	$1,002	$17,085
1986-87	$12,174	$3,804	$411	$1,167	$979	$18,535
1987-88	$12,486	$4,108	$590	$1,345	$1,592	$20,121
1988-89	$13,568	$4,466	$911	$1,517	$1,767	$22,229
1989-90	$15,013	$4,797	$781	$1,634	$1,943	$24,168
1990-91	$15,773	$5,252	$602	$1,770	$1,770	$25,167
1991-92	$16,350	$5,629	$399	$2,013	$1,770	$26,161
1992-93 (proposed)	$15,928	$7,044	$558	$2,238	$1,770	$27,538
1993-94 (proposed)	$14,210	$9,332	$558	$2,227	$1,770	$28,097

Source: Legislative Analyst, 1993b.

Table 2
Percent of Education Funding By Source
1983-84 Through 193-94
(All Numbers Are Percentages)

Year	State Funds	Local Property Tax Levies	Lottery Funds	Federal Funds	Other Local Sources
1984-85	65.2	21.6	-	7.2	6.0
1985-86	63.2	21.0	3.3	6.6	5.9
1986-87	65.7	20.5	2.2	6.3	5.3
1987-88	62.1	20.4	2.9	6.7	7.9
1988-89	61.0	20.1	4.1	6.8	7.9
1989-90	62.1	19.8	3.2	6.8	8.0
1990-91	62.7	20.9	2.4	7.0	7.0
1991-92	62.5	21.5	1.5	7.7	6.8
1992-93 (proposed)	57.8	25.6	2.0	8.1	6.4
1993-94 (proposed)	50.6	33.2	2.0	7.9	6.3

Calculated from data in Table 1.

Figure 1
California General Fund Expenditures: 1989-90 to 1993-94

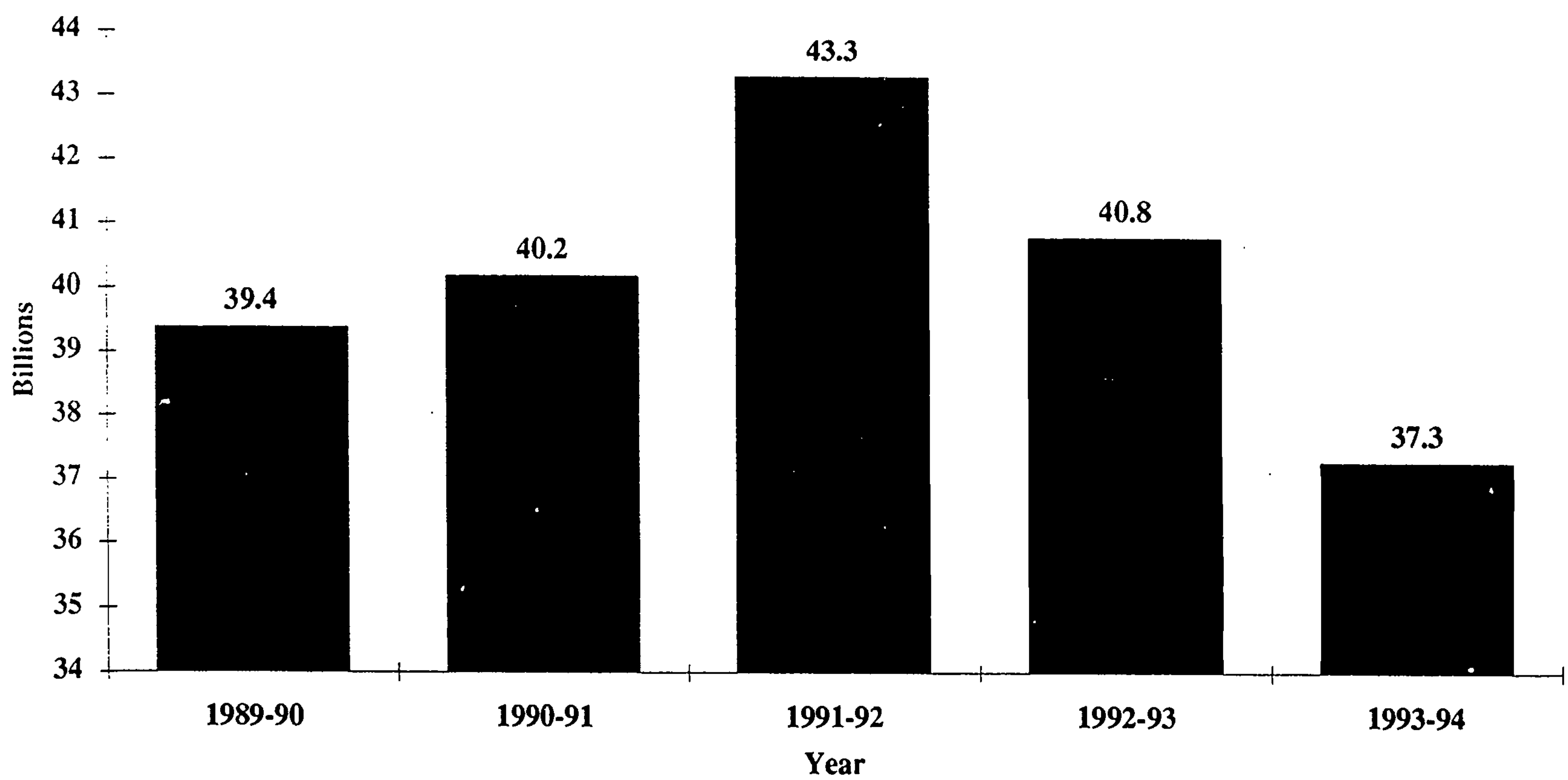


Figure 2
California General Fund Expenditures Per Capita
Adjusted For Inflation

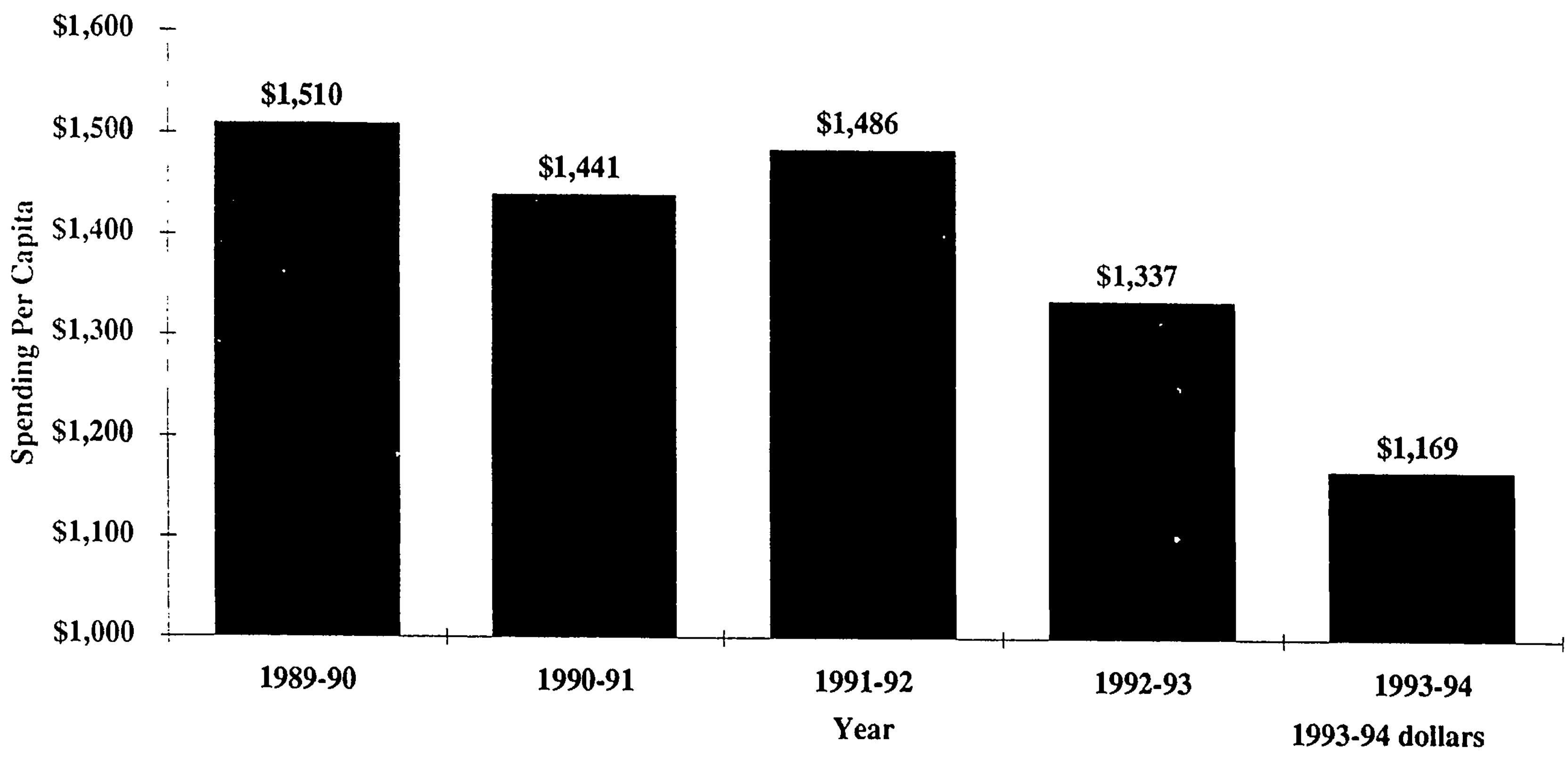
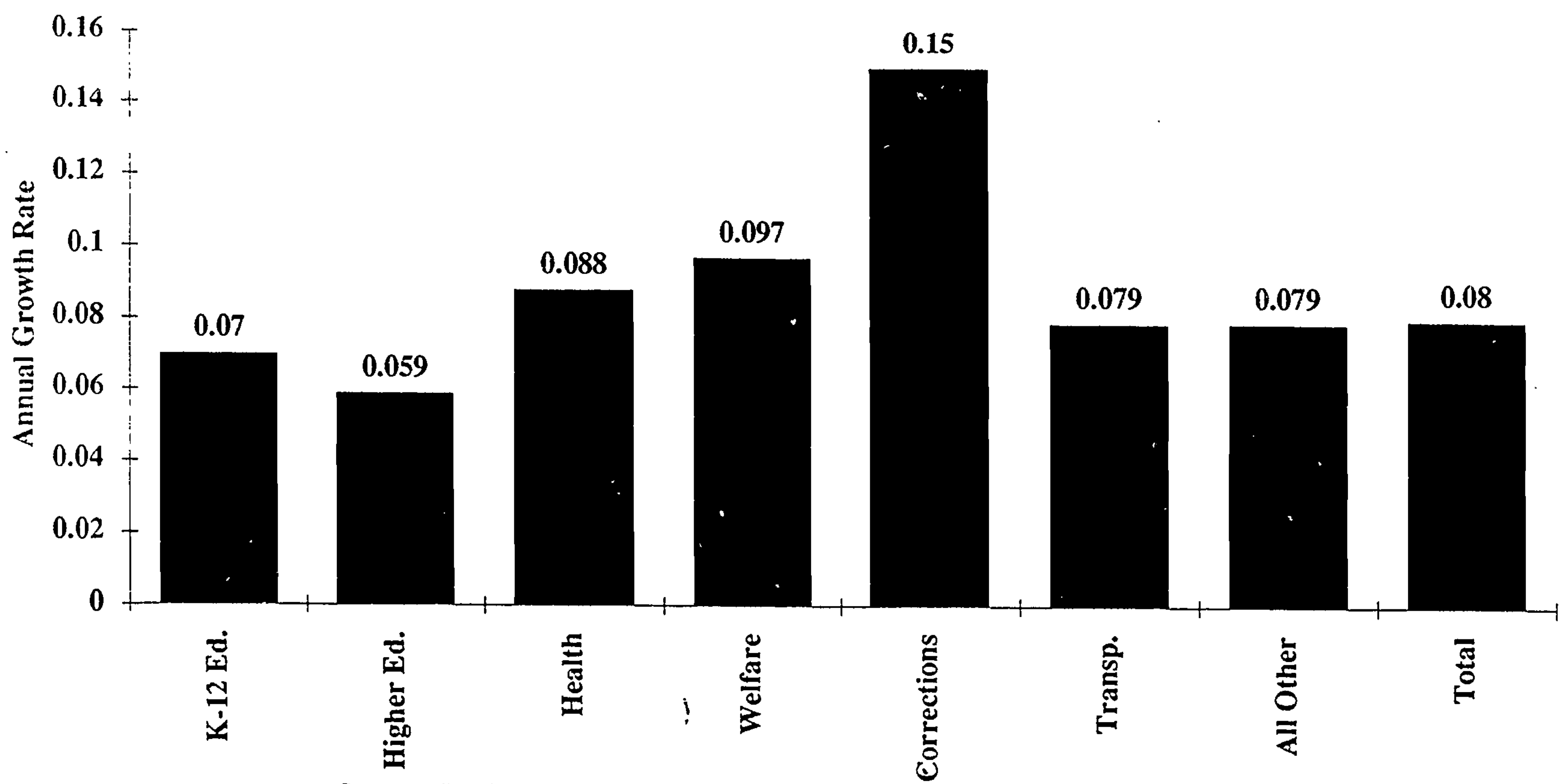
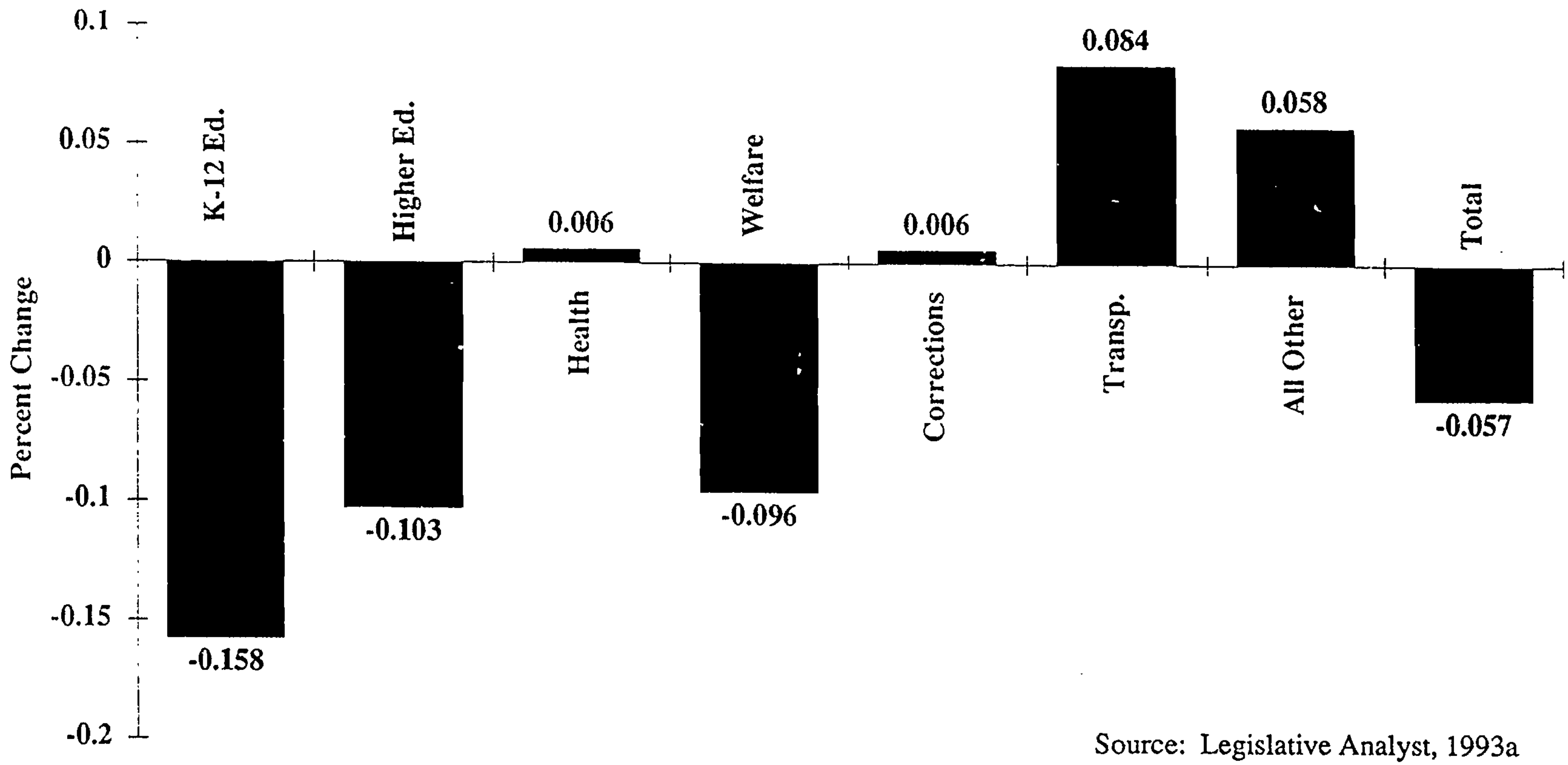


Figure 3
Annual Growth Rates: 1983-84 to 1992-93



Source: Legislative Analyst (1993a)

Figure 4
Proposed Growth Rates for 1993-94



Source: Legislative Analyst, 1993a